STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois-American Water Company	)	
	)	
	)	
	)	Docket No. 02–0690
	)	
Proposed general increase in water and sewer rates.	)	
	)	

INITIAL BRIEF OF THE CITIZENS UTILITY BOARD

Now comes the Citizens Utility Board, by and through its attorney, and files this, its Initial Brief in the above-referenced docket and in support thereof states as follows:

Procedural History

On or about September 20, 2002, Illinois American Water Company ("IAWC") filed tariffs seeking a revenue increase of $36,256,254 for all of its service territories combined. On October 18, 2002 the Administrative Law Judge served the company with a notice of deficiency and shortly thereafter on October 23, 2002, the Commission entered an order suspending the tariff and thus initiating the evidentiary phase of this proceeding.

To date, numerous parties have intervened on behalf of varying consumer interests including the Illinois Industrial Water Consumers, the Office of the Attorney General, the Cities of Bolingbrook, Streator, Lincoln and O'Fallon, and the Citizens Utility Board ("CUB").

In its filings, IAWC seeks to justify the recovery of certain costs, particularly security costs, by relying upon the September 11, 2001 terrorist attacks in New York and Washington, D.C.

In pre-filed testimony CUB recommended the disallowance of $8,680,120 of the company's requested revenue increase. The bulk of this disallowance stems from IAWC's request for deferred treatment of security costs and costs associated with a water treatment plan implemented at one of its facilities. Other proposed disallowed costs pertain to the company's treatment of specific insurance costs, payroll and chemicals expenses.

Arguments and Authorities

I. IAWC's Proposed Deferred Security Costs Should Be Disallowed

IAWC seeks to recover security costs incurred from September 2001 through August 2003. The company proposes to defer these expenses and amortize the costs over a 5-year period. IAWC's expenses fall outside the test year in derogation of long-standing regulatory principles and are therefore unrecoverable. Moreover, IAWC justifies the deferred treatment of these costs because in the company's opinion, the costs constitute "extraordinary expenses." The record, however, reflects otherwise.

A. IAWC's Proposed Treatment Of Security Costs Violates The Test Year Concept And Would Result In Over-recovery

In its filing, Illinois American proposes to amortize its September 11, 2001 through August 2003 security costs over a five-year period and include the unamortized balance in rate base. CUB witness Lafayette K. Morgan, recommends, disallowance of these costs because they represent a prior period and are outside the test year. CUB Revised Ex. 1.0, p. 6. Similarly, Staff witness Bryan Sant also recommends disallowance of these costs on the same basis.

According to Staff witness Sant, " the general ratemaking principle of a test year provides that only expenses incurred during the test year can be used to offset revenue

accrued during that year." ICC Staff Ex. 4.0, p. 5. For purposes of this proceeding, 2003 is the test year in question. However, IAWC's proposed costs, by including costs dating back to 2001, pre-date 2003 in violation of the test year concept.

To date, IAWC has not offered a compelling reason for abandoning the test year concept. *Id.* Moreover, IAWC's repeated reliance upon the possibility of post-September 11 terrorist threats without further justification is simply intended to scare regulators into meeting the company's requests. Water companies were required to provide security measures prior to the terrorist attacks and will no doubt be required to continue to do so. This alone does not justify a significant departure from traditional regulatory reliance upon the test year concept.

Aside from sidestepping generally accepted regulatory standards, IAWC's proposed treatment of security costs also creates the potential for over-recovery. During the 2001-2003 period, IAWC incurred (or anticipates incurring) $2 million per annum in security costs. According to IAWC witness Frederick L. Ruckman, the company is requesting an aggregate recovery of approximately 7.5 million in deferred costs. This amount includes a 5-year amortization of the $2 million plus any on-going security costs. Tr. 66. Thus, IAWC will likely recover more than its annual amount of costs. *Id.*

As Staff witness Sant illustrates, because IAWC has "already included a *full year's amount of security costs* in its 2003 test year . . . these 2003 deferred costs should be disallowed so as to [prevent] the Company from [recovering] the same costs twice." ICC Staff Ex. 4.0, p. 6. (Emphasis added).

Mr. Ruckman admits that the requested rates will continue to be recovered until IAWC files a new rate case. Tr. 69. Accordingly, deferred security costs will continue to

be paid by ratepayers even though the actual costs may be fully satisfied. There will be no reconciliation between the amounts collected and the actual cost incurred. Tr. 71. Therefore no failsafe exists to ensure that the company does not over collect. Without such protection in place it is imprudent to allow a probable over-recovery. Accordingly, IAWC's proposed cost should be disallowed.

B. IAWC's Security Costs Are Not Extraordinary Expenses

As noted by Staff witness Sant, and agreed to by IAWC witness Ruckman, under generally accepted accounting principles, "extraordinary expenses" are those that are deemed to be both unusual and infrequent. ICC Staff Ex. 14.0, p. 13. *See also,* Tr. 73. Here, IAWC's proposed cost recovery fails to satisfy both prongs of the test.

According to Staff witness Sant, IAWC's "deferred security costs are almost identical to the costs included as a test year operating expense." ICC Staff Ex. 14.0, p. 13. Mr. Sant also notes "the only differences are changes made because of efficiencies discovered and implemented by the Company." *Id.* Moreover, Mr. Ruckman readily admits that the costs sought were indeed recovered in prior rate cases. Tr. 68, 74. Although he attempts to characterize the differences between the costs, the record clearly demonstrates that security costs, regardless of their intended purpose, were recovered in previous years. Although CUB recognizes that when IAWC's rates were established, there was not a need for "heightened" security costs (Tr. 68) IAWC maintained security prior to September 11, 2001 and fails to justify and increase in those amounts under generally accepted accounting principles. *Id.*

It is not the purpose of the recovery that governs their categorization as "extraordinary," but their nature. The fact that IAWC responded to the events of 9/11 by

increasing security measures does not negate the fact that security costs were generally recovered in rate base in prior years and are thus considered usual and frequent thereby disallowing their recovery as an extraordinary expense.

C. IAWC's Legal Arguments In Support Of Deferred Costs Are Flawed

Throughout his testimony, IAWC witness Ruckman frequently cites Illinois caselaw in support of his contention that IAWC should be permitted to defer its security costs. However, Staff witness Sant soundly refutes this.

First and foremost, IAWC witness Ruckman lacks credibility. He is not an attorney and has no demonstrable legal experience. IAWC Ex. 1, p. 1 (Direct Testimony of Frederick L. Ruckman). Second, the cases he cites are identically cited by another IAWC witness Mark Johnson (who similarly lacks credibility and is also not an attorney). *See* IAWC Ex. R-1.0, pp. 2-3, 9-10; IAWC R-3.0, pp. 7-10;); IAWC Ex. 3.0, pp. 1-2. The references by each witness contain the identical misspellings and description of the cases. Tr. 264-268. And, as determined upon cross-examination, not only had Mr. Ruckman not read any of the cases referenced in his testimony, (Tr. 77, 82) but also neither he nor IAWC witness Johnson was able to confirm whether in fact the cases upon which they relied were still good law in Illinois. Tr. 77-78; 273.

Mr. Ruckman cites several cases in support of IAWC's argument that the events of 9/11 constitute an "extraordinary event" such that deferral of security costs is warranted. IAWC Ex. R-1.0, p. 2; pp.1-4, 9-11. One case, ICC Docket Nos. 93-0301/94-0041, concerned the deferral of costs associated with flood damage. ICC Staff Ex. 14.0, p. 16. Although the floods were considered extraordinary events, the costs "were not expected to recur year-after-year whereas the security expenses [of IAWC] are

recurring." *Id*. at p. 17. Similarly, another case, ICC Docket No. 83-0256, also involved non-recurring flood damage costs. *Id.* The instances of recoverable deferred costs cited by Mr. Ruckman are either inapposite to IAWC's current case or distinguishable there from. As such, the Commission should disallow the proposed deferral. Additionally, the Commission should give no weight whatsoever to Mr. Ruckman's and Mr. Johnson's legal analyses in light of their demonstrated unfamiliarity with the cases cited, lack of legal knowledge/background and obvious duplication of one another's testimony.

II. IAWC's Reverse Osmosis Costs Should Be Disallowed

IWAC seeks to include the costs of reverse osmosis treatment in its revenue requirement. According to IAWC witness Mark L. Johnson, IAWC's predecessor, Northern Illinois Water Company ("NIWC"), experienced difficulty in complying with the Illinois Environmental Protection Agency's ("IEPA") nitrate standards. IAWC Ex. R-3.0, pp. 5-6. NIWC then initiated a pilot study to determine the appropriate means of controlling the nitrate levels. *Id.* at 6.

The nitrate study disclosed at least six options for addressing the nitrate levels. *Id.* One of these was reverse osmosis treatment. The study was conducted in 1993 (Tr. 286) but the company did not seek to obtain the equipment necessary to implement the treatment until June 26, 2001. *Id. See also*, ICC Staff Cross Ex. 1.0, p. 2.

As explained by CUB witness Lafayette K. Morgan, IAWC's reverse osmosis costs were not associated with the study to reduce high nitrate levels and "really pertained to the implementation of the alternative previously studied and explored by the company" and as such the recovery of these costs should be disallowed in this proceeding. CUB Revised Ex. 2.0, p. 3. Staff witness Mary H. Everson supports Mr. Morgan's position

and states "the Company has improperly recorded [reverse osmosis costs] as study and investigative costs, when they are actually operating expenses from a prior period." ICC Staff Ex. 2.0, pp. 5-6. Moreover, as IAWC witness Johnson indicates, a pilot study was required for permanent installation of treatment equipment, however, in the case at bar, the equipment was removed within 30 days of installation. Tr. 291-294.

The record clearly illustrates that implementation of the reverse osmosis treatment was not study-related. All pilot studies, particularly those undertaken with the consent or knowledge of the IEPA, require that a report be forwarded to the agency. Tr. 276. In the case at bar, IAWC neither developed nor provided the IEPA with such a report. *Id.* Instead, the company requested "immediate" delivery "as quickly" as the vendor could arrange to provide the necessary equipment "including over the weekend." ICC Staff Cross Ex. 1.0, p. 2.

Such language does not indicate that the decision to implement the reverse osmosis treatment was one borne of great deliberation. Instead, by all appearances, this was an emergent attempt by IAWC not to violate IEPA standards by exceeding the maximum contaminate levels ("MCL"). Tr. 291. While the company should take all immediate and necessary actions to remedy any problems in its water treatment facilities, not all remedies are recoverable in rate base. Nothing in the record, other than IAWC's self-serving testimony, supports recovery of these costs. Indeed, under cross-examination, IAWC witness Johnson implausibly argued that the company rented temporary equipment, filed for an IEPA permit to install the equipment and decided to conduct a study—all on the same day—June 26, 2001. Tr. 290.

At the same time that IAWC asserts that the reverse osmosis treatment was a study therefore worthy of cost recovery, IWAC witness Johnson also states that the need to use the treatment was "a one-time extraordinary event." Tr. 294. This position is simply untenable. On the one hand, IAWC claims that the treatment constituted a study (which was actually performed in 1993 and reflected in an April 1995 report), but on the other the "study" has all the hallmarks of an emergency—an unrecoverable cost in this proceeding. Further attenuating its shaky position, IAWC also argues that the temporary reverse osmosis treatment utilized in 2001 for approximately 28 days (Tr. 287-288) continues to benefit today's customers, now and "forever." Tr. 294. However, the company's testimony suggests that the nitrate level issue was addressed by IAWC's installation of an ion exchange treatment in 2002. IAWC Ex. R-3.0, p. 7.

Because IAWC cannot prove that the costs associated with the temporary use of the reverse osmosis treatment were actually pilot study costs, the Commission should disallow recovery of these costs. The weight of the evidence contradicts IAWC's assertions.

III. Return on Equity

As indicated by CUB witness Lafayette K. Morgan, CUB adopts Staff's recommendation that IAWC's overall rate of return be set at 10.27%. CUB Revised Ex. 2.0, p. 9.

Conclusion

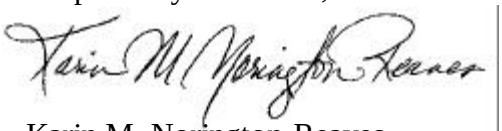
In this post-September 11th era, it is tempting to speculate about security risks and associated costs. However, in the case at bar, Illinois American Water has not demonstrated that the costs it has or will incur comply with generally accepted

accounting principles and therefore merit deferral or treatment as "unusual and infrequent" costs. Additionally, the company's treatment of these costs allows for over or double recovery in contravention of regulatory principles. For these reasons, the Commission should disallow the deferral and amortization of Illinois-American's security costs.

Similarly, Illinois-American has not proven that its reverse osmosis treatment costs are recoverable as study costs. The great weight of the evidence contradicts this assertion. Therefore, the Commission should also disallow these costs.

Wherefore, for the reasons stated above, the Citizens Utility Board respectfully requests that the Commission disallow $8,680,120 of Illinois American Water Company's requested revenue increase and adopt the recommendations of CUB witness Morgan.

Respectfully submitted,



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